

CORPORATE FINANCE II (11851)

This course addresses the firm's financial decision problem relating the cost of funds to the returns required by the firm's investors. The course focuses on the problem of determining a firm's optimal capital structure and minimizing its cost of capital explaining different theoretical approaches, their limitations and applications. It also covers pricing problems (in particular the pricing of debt, convertible debt and warrants issued by a firm) and dividend policy models.

Course objectives

This course deals with corporate finance issues and answers questions such as: is a firm financing policy relevant to determine the firm's market value? How to value bonds, convertible bonds and warrants? How to structure a firm's dividend policy?

PART I: Introduction and Recap

We recall some fundamental concepts: securities equilibrium valuation (CAPM), options (Black and Scholes' formula), investment project valuation (NPV and OCC)

Topic 1. Introduction

Reference: B-M, chapter 1

Topic 2. Financial Theory I

2.1 Risk and Return: CAPM

2.2 Arbitrage and Option Pricing

References: B-M, chapters 7-8, 20. Notas de Economía Financiera I

Topic 3. Firm's Investment

3.1 Under Certainty: NPV

3.2 Under Uncertainty: OCC

References: B-M, chapters 2-6, 9

PART II: Corporate Financing

In this part we analyze (i) the relationship between a firm's capital structure and its value and (ii) how to value a firm's investment projects and the securities it issues.

Topic 4. Capital Structure

Modigliani-Miller theorems: how does a firm's capital structure affects its market value. Also, what happens when MM hypothesis change?

4.1 Empirical Evidence

4.2 Irrelevance: Modigliani-Miller I

4.3 Risk and return as a function of leverage (D/E): Modigliani-Miller II

4.4 When M-M breaks down: Imperfections

- * Incomplete Markets
- * Imperfect Markets: Taxes
- * How Capital Structure Affects Cash-Flows

4.5 Corporate Taxes: Modigliani-Miller III

4.6 Personal Taxes: Miller

4.7 Other Theories

- * Jensen and Meckling
- * Myers and Majluf
- * Myers

References: B-M, chapters 13-14, 17, 18

Topic 5. Valuation, Financing and Investment with Taxes

We consider in a more rigorous way the valuation problem and firm's optimal investment rules

5.1 the Additivity Principle

5.2 Evaluating a Firm's Assets

- * The Weighted-Average-Cost-of-Capital (WACC) Formula
- * The Adjusted Present-Value (APV) Rule

5.3 Valuation with Taxes

- * CAPM with Taxes
- * WACC and APV with Taxes

5.4 Interactions of Investment and Financing Decisions

Reference: B-M, chapter 18

Topic 6. Valuation of a Firm's Securities

We analyze methods to evaluate the different securities a firm issues. Starting from the value of these securities we obtain the firm's market value

6.1 Valuation and *Rating* of a Firm's Debt

6.2 Valuation of Convertible Securities

- * Warrants

* Convertible Debt

Reference: B-M, chapters 22-24

PART III: Dividend Policy

How does a firm's dividend policy affects its shareholders' wealth? We are asking again the same question: do a firm's financial decisions affect its market value?

Topic 7. Dividend Policy

7.1 Dividends and Share Repurchase

7.2 Empirical Evidence

7.3 Some Theories

* *A bird in the hand is worth two in the bush...*

* Irrelevance: M-M

* Taxes: Share Repurchase are Better

* Tax Clienteles

* Other Theories

- Batthacharya

- John and Williams

- Kumar

Reference: B-M, chapter 16

Basic Reference

Brealey R. And S. Myers: *Fundamentos de Financiación Empresarial*, 5ª edición, McGraw-Hill, Madrid, 1998.

Further Readings

Benninga, S. and Sarig O.: *Corporate Finance: A Valuation Approach*. McGraw-Hill, 1997.

Chew, D. *The New Corporate Finance: Where Theory Meets Practice*. 2ª ed. McGraw-Hill, 1998.

Copeland and Weston. *Financial Theory and Corporate Policy*. Addison-Wesley 1992.

The Economist *The Party is Over: A Survey of Corporate Finance*, January 27th, 2001.

Van Horne, J. *Administración Financiera*. 10ª. Ed. Mexico: Prentice-Hall Hispanoamericana, 1997.